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The Changing Legal Framework of International Energy Management†

As recent events have shown, the energy situation has continued to be somewhat critical, and it doubtless would become so even absent the cartelization of production by the Organization of Petroleum Exporting countries. The crisis is partly political, partly economic; in either case there has been an erosion of the legal frameworks for international oil business which must be recreated if there is to be reliable exploration, production, and pricing consistent with world needs.

The legal institutions so laboriously established to protect foreign commerce in the past have not been adequate to meet the nationalist demands of newly powerful countries. At best, international law is not self-executing, but rather depends on the consensus of nations with respect to political and moral precepts. The accession of great numbers of newly independent countries to the community of nations, many with ancient cultures or new economic regimes far different from those dominating the international community in the past, are bound to put unprecedented strains on this consensus.

In examining this unique problem, one must consider some of the legal assumptions upon which international energy management operated from the beginning of the industry until the late 1960s. First, it was assumed that the exploitation of mineral resources was an appropriate enterprise for private industry. While such industries were nationalized in some states in connection with complete social reorganization, and specific industries, like Britain's coal, were nationalized in others, the vast majority of petroleum production was conducted by private companies for profit. The capital for such exploitation came from private sources and frequently from sources outside of the producing country. The necessary capital investment was made on the

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assumption that such investment would be protected and profits would be repatriated.

It was assumed that management was entitled to determine production levels, quality control, pricing, marketing arrangements, and so on. There were no requirements as to local hiring and no penalty for failing to explore a concession, or failing to exploit a discovery. All that was needed from the host government was license to conduct the business as a corporation, title to the petroleum, and surface rights necessary for production and transportation. These rights were obtained in the form of concession agreements, for which the host government received rent, a bonus and royalties. The earliest agreements did not even address management rights. These agreements covered huge territories, and purported to extend for decades, some for the century. In the United States it was even easier; one needed only to purchase the land and drill.[1]

Considerable evolution in the Middle Eastern agreements has taken place over the years. As profits grew after World War II, the major companies there agreed to a tax based on tonnage produced, amounting to roughly 50 percent of the concessionaire's profits as computed from tax reference prices.[2]

But throughout the 1960s there was general acceptance of certain basic legal premises: Management was entitled to run its business as it deemed appropriate to maximize profits, its property was entitled to respect and protection, and contractual rights were pretty well respected. Such precepts may have a Western, or even Anglo-Saxon ring to them. It may be that their practically universal acceptance derived from the force of Western arms and colonialist policy. But, regardless of their source, they constituted a generally accepted legal regime for the conduct of the international oil business and on the basis of such assumptions, investments were made, supplies assured and prices determined.

This framework is now in shambles. In many areas of the world with important petroleum reserves, the sanctity of contracts has been undermined by assertions of the debilitating and highly slippery qualification of *"rebus sic standibus"* ("circumstances remaining unchanged") or attacks based on their unconscionableness or the circumstances of negotiation. Freedom of management is also carefully circumscribed to ensure maximum benefit to the state rather than maximum profit. In many countries, the very title to foreign property is now deemed subject to the over-riding economic prospects of the state.

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[1]*See generally,* Best, *Middle East Oil and the U.S. Energy Market,* 5 LAW & POL. IN INT'L BUS. 215 (1973); *Mining the Resources of the Third World: From Concession Agreements to Service Contracts,* 1973 AM. SOC. INT'L LAW PROC. 227 ff; Note, *From Concession to Participation: Restructuring the Middle East Oil Industry,* 48 N.Y.U.L. REV. 774, 775-85 (1973).

[2]*See id.* at 778.

The causes are diverse, but the reduction of Western influence abroad must be deemed the most important causal factor. One can point to the British withdrawal from the Middle East; and to the decline in established influence in other areas as well, as in Latin America and Africa, where colonial rule has been virtually eliminated. Not only has Western influence on their legal systems been reduced, but countries whose economies were once run by Western governments and corporations are now independent and required to fend for themselves, to produce their own prosperity. In many cases, resource treasures appear to be a ready, if not the only, means for attaining the kind of prosperity enjoyed by the industrialized nations. Freed from the constraints of alien commercial law and responsible for their own economic destiny, the political pressures in many countries to take unilateral action independent of their international and contractual obligations has been too much, and the system upon which international oil management previously depended disintegrated.

Such changes should have been foreseeable as early as 1960. In that year, Iran, Saudi Arabia, Venezuela and other important producing nations joined together to form the organization of petroleum exporting countries. Its initial purpose was to reverse a price rollback which the companies had adopted in 1957 as a result of overcapacity. It was not entirely effective, but it did succeed in devising policies for increased tax revenues from their exports.[3]

Thereafter, various individual countries successfully renegotiated certain provisions of their concession agreements affecting training for local employees, representation on boards of directors, relinquishment of undeveloped territory, and other matters. New agreements tended to provide for mere service functions for or joint ventures with the majors.[4]

Then, in 1970, Libya demanded increased revenues on account of its accessibility to Europe following closure of the Suez Canal. When these concessions were negotiated, the other Arab producers demanded and obtained similar tax increases. Accordingly, Libya demanded still further tax concessions based on its preferred geographic position. Thus a full circle of tax increases was in progress, known as "leap frogging," all in disregard of the terms set forth in concession agreements previously agreed to. A general settlement was finally worked out in February, 1971, which it was agreed would be binding at least until 1976, but it, too, was doomed to collapse. Each amendment under the gun represented a further erosion of the reliability of contractual agreements. And in 1972, Libya, having already expropriated

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[3]*See generally, id.* at 779; Akins, *The Oil Crisis: This Time the Wolf Is Here,* 51 FOREIGN AFFAIRS Q. 462 (1973).

[4]*See generally, Mining the Resources of the Third World,* 1973 AM. SOC. INT'L LAW PROC., *supra* at 230-34 (Remarks of Frick, Assoc. Gen. Counsel, Standard Oil Co., Ind.); Note, 48 N.Y.U.L. REV., *supra,* at 780-83.

British petroleum, expropriated a number of American oil companies, and reduced production.[5]

In the Middle East, the major oil companies and ARAMCO negotiated a participation agreement, whereby Saudi Arabia and the other governments would acquire a 25 percent interest in their operations immediately, rising to 51 percent after 1981. Subsequently, largely as a result of Libya's actions and a complete takeover in Iraq, this agreement has unraveled, and the governments are now demanding 100 percent ownership. Kuwait and Qatar already have 60 percent participations in operations in their countries.[6]

What are the effects of these events? Be it immediate or after a few years, total control of the principal sources of international petroleum will have passed to the governments of the host countries. Most management prerogatives have effectively changed hands already. In the boycott a year ago, American corporations were obliged to terminate direct supplies to the United States. Production levels and exploration levels are dictated by the host government. The companies' much touted function of buffering relations between the consuming governments and the producers is entirely gone.

In the future, the oil companies' role will be primarily that of service organizations retained to provide the expertise necessary for exploration and production, to some degree the transportation, and to a degree which may continually change, the marketing. The role once played by the companies in negotiating price and supply must now devolve on the governments of the consuming countries.

Some of these changes appear fair and appropriate for renegotiation, such as managerial training for qualified local applicants, conservation controls, and production quotas. It is hard to deny participation provides a fairer return to the host country than the early 20th century concession. But with majority control passing to the host governments, the role of international management has changed indeed. The power to control prices, the power to ensure fair geographical distribution, are no longer present. Where such powers were once checked and balanced by dispersion among a number of competing corporate entities interested in the good will of the governments of those countries in which they marketed and resided, there has now arisen an effectively unrestrained monopoly control over prices and production by the OPEC countries.[7]

And of course, the reliability of contract upon which international as well as domestic commerce depends is compromised. Reference is frequently made to

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[5]*See id.* at 784-86; Akins, *supra*, at 470-75.

[6]*See* Note, 48 N.Y.U.L. REV., *supra*, at 786-814.

[7]*See generally* Levy, *World Oil Cooperation or Economic Chaos*, 52 FOREIGN AFFAIRS Q. 690, 693-98 (1974).

resolution 1803 of the General Assembly of the United Nations which provided that "the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the state concerned."[8] That resolution was adopted in 1962, and represented a kind of compromise between countries seeking confirmation of their sovereign right to dispose of their wealth and natural resources and the industrial countries seeking recognition of the necessity of honoring commitments and of treating foreign capital in accordance with the requirements of international law. As a compromise, resolution 1803 paid lip service to both interests, remained vague, and has been used by both importers and exporters ever since. It did not change international law with respect to treatment of foreign capital, and one may ask whether it represented anything new with respect to sovereignty over resources. Such sovereignty had been recognized from the earliest concession agreements, and presumably, the right of sovereignty includes the right of alienation or disposal. The real issue is that of contract, and on that score, resolution 1803 provided that, when foreign capital is authorized it shall be governed by the terms of such authorization and by international law, as well as domestic law.[9]

The international protection to be accorded foreign investment was confirmed in 1973 by a sole arbitrator appointed by the president of the Court of International Justice, to arbitrate the claim of British Petroleum against Libya, on account of its nationalization.[10] The arbitrator confirmed that BP was entitled to compensation under international law, an award which itself has been ignored by Libya. The arbitrator also stated, however, that BP was not necessarily entitled to the oil subsequently produced from its former concessions. BP and other companies are nevertheless pursuing a claim to such oil, sometimes referred to as "hot oil," in some 37 different legal actions around the world.[11]

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[8]Resolution 1803, 17th Sess., December 14, 1962, U.N. Doc. A/RES/1803 (XVII), 2 INT'L LEGAL MAT'LS 223 (1963).

[9]Paragraphs 3 and 8 of Resolution 1803 provide:

> 3. In cases where authorization is granted [to explore or develop natural resources], the capital imported and the earnings on that capital shall be governed by the terms thereof, by national legislation, and by international law. The profits derived must be shared in the proportions freely agreed upon, in each case, between the investors and the recipient State, due care being taken to ensure that there is no impairment, for any reason, of that State's sovereignty over its natural wealth and resources. . . .
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> 8. Foreign investment agreements freely entered into by or between sovereign States shall be observed in good faith . . . .

The Charter of Economic Rights and Duties Among States, Res. 3281, 29th Sess., Dec. 12, 1974, U.N. Doc. A/RES/3281 (XXIX), 14 INT'L LEGAL MAT'LS 251 (1975), however, asserts a right to expropriate with a duty only for "appropriate" compensation. None of the western capital-exporting countries voted for the Charter.

[10]Unpublished by agreement of the parties.

[11]In BP Exploration Co. (Libya) Ltd. v. Astro Protector Compania Naviera S.A. (Ct. of Syracusa, Italy, February 15, 1973), 13 INT'L LEGAL MAT'LS 106 (1974), an Italian court rejected BP's claim to

To an overwhelming degree, the problems of international energy management have become more diplomatic and less legal.[12] Nevertheless, there remain a number of areas relating to international oil trade in which legal responses have been made, which should give us hope. The principal areas of legal success have been with respect to pollution.[13]

Under the auspices of the Intergovernmental Maritime Consultative Organization, an International Convention Relating to Intervention on the High Seas in Cases of Oil Pollution Casualties was negotiated in 1969.[14] This convention gives coastal states the right to destroy or tow away stranded vessels that pose an oil-spill hazard. An International Convention of Civil Liability for Oil Pollution Damage was also negotiated in 1969, which provides liability for oil carriers regardless of negligence.[15] It limits liability to $15.2 million, however, if that amount is put in escrow at the outset of the claim. Participating states are also required to demand that their ships carry certificates of financial responsibility for pollution liability. In addition, there is an international convention on the establishment of the 1971 International Funds for Compensation for Oil Pollution Damage, to which oil cargo carriers are required to contribute.[16]

Perhaps of most importance, as the world faces increasing reliance on atomic energy, is the 1972 Ocean Dumping Convention.[17] This convention prohibits dumping at sea of certain dangerous substances from vessels, aircraft, and

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title to Libyan oil extracted after expropriation. *But see* U.S. Dep't of State, *Statement on "Hot" Libyan Oil,* May 7, 1974, 13 INT'L LEGAL MAT'LS 762-82 (1974); *Recovering Confiscated Assets and Capturing Sanctioned Goods: Extant and Prospective Remedies,* 1973 AM. SOC. INT'L LAW PROC. 71 ff.

[12]*See, e.g., Resolutions of Organization of Petroleum Exporting Countries* Nos. 155 (June 28, 1973), 158-160 (September 16, 1973), 13 INT'L LEGAL MAT'LS 220-22 (1974); *Agreement Establishing the Latin American Energy Organization* (November 2, 1973), 13 INT'L LEGAL MAT'LS 377-89 (1974); *Communique of the Washington Energy Conference,* February 13, 1974, 13 INT'L LEGAL MAT'LS 462-64 (1974); *Organization of Petroleum Exporting Countries Declaration Concerning the International Economic Crisis,* March 6, 1975, 14 INT'I LEGAL MAT'LS 566-67 (1975); *Communiqué and Declaration of Organization for Economic Co-operation and Development,* May 30, 1974, 13 INT'L LEGAL MAT'LS 995-99 (1974); *Conference of Developing Countries on Raw Materials, Dakar, Action Program and Resolutions,* February 8, 1975, INT'L LEGAL MAT'LS 520 (1975).

[13]*See* Muir, *Legal and Ecological Aspects of the International Energy Situation,* 8 INT'L LAWYER 1 (1974).

[14]November 29, 1969, 9 INT'L LEGAL MAT'LS 25 (1970); S. EXEC. G. 91st Cong., 2d Sess. (1970). Ratification of the International Conference Relating to Intervention on the High Seas in Case of Oil Pollution Casualties was approved by the U.S. Senate on September 20,1971.

[15]November 29, 1969, 9 INT'L LEGAL MAT'LS 45 (1970), S. EXEC. G. 91st Cong., 2d Sess. (1970).

[16]December 18, 1971; 11 INT'L LEGAL MAT'LS 284 (1972); S. EXEC. K. 92nd Cong., 2d Sess. (1972).

[17]December 29, 1972, 11 INT'L LEGAL MAT'LS 1294 (1972). *See also, International Convention for the Preservation of Pollution of the Sea by Oil,* 1954, *as amended,* 9 INT'L LEGAL MAT'LS 1 (1970); *International Convention on the Dumping of Wastes at Sea,* 1972, 11 INT'L LEGAL MAT'LS 1294 (1972); *International Convention for the Prevention of Pollution from Ships,* 1973, 12 INT'L LEGAL MAT'LS 1319 (1973).

platforms except as licensed by appropriate authorities in the party states. Specifically included are oil, mercury, and high-level radioactive wastes.

There has also been considerable international cooperation with respect to research and development. For the present, the universal need to reduce world oil consumption seems to outweigh national desires to monopolize technological advantages. There are a great number of bilateral agreements between the United States and foreign governments to pursue particular research and development projects. In 1973, energy related projects were selected for implementation of the 1972 agreement on cooperation in the fields of science and technology between the United States and the Soviet Union. The United States and Japan entered into a formal agreement for research in fusion and breeder reactor technology and preparations were undertaken for a more comprehensive energy research and development agreement. There are a great number of other such agreements.[18]

There are also a number of multilateral research and development efforts in energy. Perhaps most important is the International Atomic Energy Agency established in 1956. The NATO committee on challenges of modern society has undertaken cooperative development projects in solar and geothermal technology. The OECD has commenced a study of its members' programs relating to energy as well as energy research and development. There are numerous other projects between the United States and groups of other particularly interested countries, on projects such as coal research, fast reactor accident prevention, mineral exploration and other matters. Some are governmental only; others contemplate the contribution of private industry.[19]

But clearly the most important issues are still before us. In October, 1973, the Arab producers embargoed shipments of oil to the United States and the Netherlands. At present, there is apparently no principle of international law which bars such an embargo *per se* in the absence of applicable treaties.[20] Foreign trade has always been a matter within the prerogative of sovereign governments. A number of commentators have referred to the principles of friendly relations among states adopted by the United Nations, to refrain from economic coercion, and obligations in the United Nations charter itself to abstain from acts which threaten the peace. But these are general principles, and have been universally ignored in the particular case of foreign trade.

The General Agreement on Tariffs and Trade[21] does contain certain provisions which are pertinent. That agreement was originally negotiated after

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[18]*See generally,* Pollack & Congdon, *International Cooperation in Energy Research and Development,* 6 LAW & POL. IN INT'L BUS. 677 (1974).

[19]*Id.*

[20]*See* Muir, *The Boycott in International Law,* 9 J. INT'L LAW & ECON. 187 (1974); Shihata, *Destination Embargo of Arab Oil: Its Legality Under International Law,* 68 AM. J. INT'L LAW 591 (1974).

[21]Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187. All major non-Communist

World War II to ensure access to markets, and its principal effect is to bar discriminatory tariffs. It also contains language, however, to ensure access to the exports of other countries.

It provides, for example, that a country should not impose export restriction except in certain circumstances, and if it does, it must do so in a manner which gives recognition to historic trade patterns between itself and countries which it has traditionally supplied.[22] Unfortunately, a number of crucial oil producing countries have never subscribed to this agreement, including Iran, Iraq, Libya, Saudi Arabia, the Soviet Union, and Venezuela.

Agreement has been reached among a number of industrialized states with respect to sharing available oil supplies in event of a crisis shortage.[23] If a shortage amounting to 7 percent affects all the parties, they will be committed to reducing their demand by 7 percent. If the shortage reaches 12 percent, the parties are required to reduce demand by 10 percent and if deemed necessary, the parties would be required to use reserve supplies and share all oil in their possession, including imports and domestic supplies. Allocations would be made by the quasi-independent industry advisory body in the International Energy Agency. The program would also help individual countries faced with supply problems, again, when the shortage reaches 7 percent.

Those who have worked with the OECD's International Advisory Board, which was established to equalize the flow of crude to Europe, will understand the kinds of problems to be anticipated in implementing the proposed system. Extensive data collection and reporting; infinite meetings and discussions; and urgent reroutings, diversions, and sales revisions, are all part of the game. While industry cooperation in past crises has been noteworthy, the new system will be mandatory under the laws of participating states, and presumably the antitrust problems which the companies faced in their efforts to cooperate in the International Advisory Board and in the Emergency Petroleum Supply Committee in the United States will be resolved. The sharing agreement is a limited one, however, obviously, a response rather than a cure to the continuing crisis in international energy trade.

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trading nations are parties to the "GATT."

[22]Article XI provides,

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures shall be instituted or maintained . . . on the exportations of any product destined for the territory of any other contracting party.

Articles XI and XII provide for a number of exceptions, as to relieve critical food shortages or safeguard a party's balance of payments. But Article XIII specifies that any quotas adopted must allocate in such a way as to take account of historic trading patterns. An exception in Article XX relates to conservation measures to protect exhaustible natural resources, but that too is subject to the requirement that such restrictions "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail."

[23]*Agreement on an International Energy Program,* Paris, November 18, 1974, 14 INT'L LEGAL MAT'LS 1 (1975).

What about other existing treaties and institutions? The World Bank and the International Monetary Fund have been grappling with the monetary fall-out of the precipitous rises in oil prices, but they are constitutionally unequipped to address the underlying issues of price, production and accessibility. The fund has established a facility to provide financing to countries threatened by petroleum deficits.[24] But, again, this is only ameliorating the effects, rather than treatment of the underlying problem.

Unhappily, it must be concluded that existing organizational schemes are inadequate for the most important issues: price, access, and investment of capital. What is required is an entirely new legal-diplomatic effort, of the same magnitude as the ongoing Law of the Sea Conference. The importance of pricing to the world's economic stability is evident from the state of Italy's economy as well as that of numerous other nations, both industrialized and non-industrialized.

What is needed is a forum for the negotiation of prices in the full light of the interests of *all* peoples of the world. What are needed are guidelines or criteria for determining fair price including fair pay for labor, compensation for depletion of resources, return on capital, but no less importantly, the dependency of the world's economic development on access to energy at a reasonable cost.

There is no reason such guidelines cannot be agreed upon. All that is needed is an appropriate forum, good faith, and confidence. With these the apparently irreconcilable can be compromised. To borrow a term from labor-management negotiations, what is needed is a forum for "collective bargaining."

Such a forum is, I submit, entirely within the range of our diplomatic and legal experience and capacity. Oil is, after all, merely another commodity—perhaps more crucial than sugar, but certainly not more so than wheat. As early as 1948, a United Nations conference on trade and employment drafted a charter for an international trade organization.[25] That charter contained extensive provisions relating to the establishment of commodity agreements, objectives, voting and other operational matters. Some of its provisions are timely indeed—Article 63 provided that such agreements should be designed, ". . .to assure the availability of supplies adequate at all times for world demand at prices which are in keeping with the provisions of Article 57(c) . . . ." That Article goes on to provide that voting should be allocated so that the votes of all consuming countries equal the votes of all exporting countries. Commodity agreements have been adopted in the past, they have operated, and have grappled with issues no less complex and highly charged. In particular, one

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[24]IMF Exec. Bd. Dec. 4241-(74/67) adopted June 13, 1974; renewed Exec. Bd. Dec. 4634-(75/47) adopted April 4, 1975 (designed to make resources available to countries suffering balance of payments problems as a result of increased costs for oil imports).

[25]*See* 14 WHITEMAN, DIGEST OF INTERNATIONAL LAW 618 ff. (1970).

may refer to the Wheat Trade Convention of 1967, and its predecessor, the International Wheat Council. That convention establishes certain maximum and minimum prices subject to adjustment by a price review committee. The International Tin Agreement created buffer stocks and set prices to trigger sales and purchases to stabilize the world market. Equally sensitive, but less price oriented negotiations were once conducted under the International Coffee Agreement.[26]

It is usually asked, what inducement is there for the OPEC countries to participate? Two are readily apparent. One is their sense of international responsibility, which is attested to by the repeated statements by Sheik Yamani concerning the need for a dialogue among producers and consumers, and by the Shah of Iran concerning possible meetings between OPEC and the OECD.[27]

In addition, the producing countries are acutely aware that their economy is based upon a wasting asset, and that unless they provide an alternative base for their economy over the next decades, they may lose their only chance to achieve prosperity and development. And it is precisely in these fields of economic planning, of science and technology, and of industrial development, that the consuming countries can provide something to the producers which they desperately need. A commitment from the consumers to provide an alternative economic base against the day of resource exhaustion, and to provide security for capital invested from oil profits, might not be deemed an unreasonable basis for consent to collective bargaining on price.[28]

Unless these issues are dispassionately addressed in a spirit of compromise and mutual benefaction, the prospects for world peace cannot be viewed very sanguinely. The world's economy cannot be left to the unilateral discretion of a single bloc of countries, be they producers or consumers. Nor can the world be allowed to revert from freedom and development to a kind of reverse imperialism.[29] It is hoped the producers will act from a sense of social responsibility to the world as well as to their peoples. The issues are urgent and crucial to the world's economy as it adjusts to the post-petroleum age.

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[26]*See id.*, at 638-80.

[27]Admittedly, these and statements to like effect by other Arab leaders preceded the debâcle at the proposed producer-consumer conference in Paris in April, 1975. (*See, e.g.*, advertisement of Iraqi Interest Section in the Washington Post, February 11, 1974, headlined, "Today the Major Energy Consuming Nations are Meeting in Washington. Iraq believes all consuming and producing countries should be meeting in the United Nations.") While differences as to agenda (the producers insisted on discussing *all* raw materials at Paris) may persist, a predilection of producers to negotiate with governments concerning their patrimony rather than with the multinational oil companies appears constant. In any event, increased participation by the U.S. government in negotiations concerning price and production so long eschewed because of *laissez faire* policy and fear of politicalization, now seems essential.

[28]A concern for security vis-à-vis the Soviet Union must also be a consideration. *See* Levy, *supra*, n. 7 at 705-06.

[29]Compare the provisions in the Charter of Economic Rights and Duties of States, *supra* n. 9: *Article 24.* All States have the duty to conduct their mutual economic relations in a manner

which takes into account the interests of other countries. . . .
Article 31. All States have the duty to contribute to the balanced expansion of the world economy, taking duly into account the close interrelationship between the well-being of the developed countries and the growth and development of the developing countries, and the fact that the prosperity of the international community as a whole depends upon the prosperity of its constituent parts.